ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Rod Pacheco	Analyst:	Roger Lackey	Bill Number:	AB 238
Related Bills:	See Legislative History	Telephone:	845-3627	Introduced Date:	02-13-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Net Operating Loss Sustained By Farmers From Pest Infestation/Allows Deduction Carryover Until Loss is Used

SUMMARY

This bill would allow special net operating loss (NOL) treatment for losses sustained by farmers as a result of pest infestations.

In addition, this bill would reduce the carryover percentage of general NOLs to 50% and would reduce the carryover period to five years.

PURPOSE OF THE BILL

Author's staff has indicated that the purpose of the bill is to provide relief to farmers experiencing significant crop damage due to pest infestations.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Author's staff has indicated that the amendments to the general NOL statutes were not intended. The bill will be amended to eliminate those changes.

ANALYSIS

FEDERAL/STATE LAW

An NOL is defined as the excess of allowable deductions (as specifically modified) over gross income. **Federal law** provides, in general, that an NOL can be carried back two years and forward 20 years. Special rules are provided for the carryback of NOLs arising from specified liability losses, excess interest losses, casualty or theft losses, disaster losses of a small business, and farming losses.

Board Position:			Department Director	Date
_____ S	_____ NA	_____ NP	Alan Hunter for GHG	03/23/01
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Existing state law conforms to the federal computation of an NOL. However, California does not allow NOL carrybacks. Depending on the type of taxpayer or amount of a taxpayer's income, the amount of the NOL that is eligible to be carried forward and the number of years it can be carried forward will vary.

Existing state law provides for seven different types of NOLs:

Type of NOL	NOL % Allowed to be Carried Over	Carryover Period
General NOL	55% (2000 - 2001) 60% (2002 - 2003) 65% (2004 - on)	10 Years
New Business Year 1 Year 2 Year 3	100% 100% 100%	10 Years
Eligible Small Business	100%	10 Years
Specified Disaster Loss	100% 50%	5 Years 10 Years
Economic Development Areas	100%	15 Years

For most taxpayers, the computed NOL may be carried forward for 10 years as follows:

- For taxable years beginning on or after January 1, 2000, and before January 1, 2002, 55% of the NOL may be carried forward.
- For taxable years beginning on or after January 1, 2002, and before January 1, 2004, 60% of the NOL may be carried forward.
- For taxable years beginning on or after January 1, 2004, 65% of the NOL may be carried forward.

In the case of corporations doing business both within and outside of this state, California, as do most states, taxes corporations exclusively on a source basis, with source income being determined by use of an apportionment formula for business income and an allocation methodology for nonbusiness income. While a state cannot tax income from sources outside the state, it is similarly not obligated to consider losses from sources outside the state. Thus, the applicable apportionment rule governing NOLs provides that a taxpayer has a California NOL based on the sum (or net) of its California-apportioned business income (or loss) and its allocated nonbusiness income (or loss).

Under existing state and federal law, taxpayers engaged in the business of farming are allowed to deduct the expenses related to planting and growing crops as an ordinary and necessary business expense.

Under existing state and federal law, farm losses may be deducted as an ordinary loss, limited to the taxpayer's farm income, in the taxable year sustained.

THIS BILL

This bill would allow special NOL treatment for losses sustained by a farmer as a result of pest infestations. Specifically, 100% of an NOL sustained by a farmer that is attributable to farming activities conducted in a pest infestation area could be carried over and offset against future income from the farm operation in the pest infestation area until exhausted. The remainder of the taxpayer's NOL that is not attributable to farming activities conducted in the pest infestation for the year sustained would be lost. The special farming loss NOL added by this bill would be carried over until exhausted.

This bill would also reduce the general NOL carryover percentage from 55% to 50% and would eliminate the carryover percentage increases that are due to occur in future taxable years. In addition, this bill would reduce the carryover period from 10 years to five years. Also, this bill would reduce the carryover period for new businesses to a maximum of eight years (in the first year of the new business, seven years in the second year of that new business, and six years in the third year of that new business). However, it should be noted the author's staff has indicated these changes relating to the general NOL statutes were unintended and will be removed from this bill.

IMPLEMENTATION CONSIDERATIONS

This bill would allow a special farming loss due to pest infestation. However, it is not clear what constitutes a "pest infestation" or what entity would make the determination that the pest infestation is responsible for the farming loss.

Once the implementation consideration is resolved, this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 2170 (Rod Pacheco, 1999/2000) would have allowed special net operating loss (NOL) treatment for losses sustained by a farmer as a result of pest infestations. This bill failed passage in the Assembly Appropriations Committee.

AB 2435 (Thompson, 1999/2000) would have allowed taxpayers a 100% credit equal to the grape crop losses sustained by a grapevine grower because of the Glassy-Winged Sharpshooter pest or Pierce's Disease. This bill failed to pass the Assembly Committee on Agriculture.

OTHER STATES' INFORMATION

The laws of Florida, Illinois, Massachusetts, Michigan, and Minnesota were reviewed because their tax laws are similar to California's income tax laws.

Florida income tax law, applicable only to corporations, provides a 20-year carryover period but does not allow carrybacks, and otherwise conforms to federal NOL rules.

Illinois income tax law conforms to federal law regarding NOLs.

Massachusetts income tax law does not allow NOL treatment for personal income taxpayers, but corporations are allowed a 100% NOL that applies to the first five years of the organization's existence.

Michigan income tax law conforms to federal NOL rules, including allowing carrybacks for corporations. However, Michigan's personal income tax law does not allow carrybacks.

Minnesota personal income tax law conforms to federal NOL rules, while corporate taxpayers are not allowed carrybacks and are allowed a fifteen-year carryforward period.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

The revenue losses from this bill, under the assumptions discussed below, are estimated to be relatively minor.

Revenue Impact of AB 238 As Introduced February 13, 2001 Enactment Assumed After June 30, 2001 **(In Millions)**			
	2000-1	2001-2	2002-3
Revenue Impact	-Minor	-$0.5	-$0.5

This analysis assumes only farm losses occurring in California would qualify since income must be attributed to the taxpayer's California source farming business income. To the extent that farm losses occurring outside California would qualify, the revenue losses would be greater. The analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

This estimate does not include the changes made to the general NOL statute since these changes were unintended by the author.

Tax Revenue Discussion

Contacts with California agricultural experts indicate that there are no state-level projections for losses resulting from all types of pest infestations. Based on information received from the State Department of Food and Agriculture and other sources, the amount of losses in California from Pierce's disease in 2001 is projected to be $20 million. If, for this bill, the total amount of farm crop losses resulting from pest infestations were $50 million, the potential NOL revenue loss would be about $500,000.

For purposes of this revenue estimate, it was assumed that: Half of the total crop loss would be sustained by taxpayers with net operating losses overall (i.e., $25 million) and that qualifying losses from pest infestations would account for 50% of those losses (i.e., $12.5 million). Thus, the additional 50% NOL carryover deduction allowed under this bill would result in a $500,000 revenue loss ($6.25 million multiplied by an 8% tax rate).

ARGUMENTS/POLICY CONCERNS

Other special NOL treatment only allows a carryforward period of six, seven, eight, or 15 years. This bill would allow the NOL to be carried forward until completely used, creating a precedent.

LEGISLATIVE STAFF CONTACT

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